KEYNOTE INTERVIEW

Continued momentum

Infrastructure is not immune to Trump's policy decisions, but the tailwinds driving demand are stronger than any economic or political cycle, says Barings' Orhan Sarayli

Demand for infrastructure debt remains strong across all sectors. While digital infrastructure and power dominate the headlines, even utilities require capital due to the growing shortfall between operating cashflow and capex needs.

Of course, the infrastructure asset class is not immune to interest rate movements. Nor is it insulated from the current volatility that is accompanying President Donald Trump's policy decisions.

However, when *Infrastructure Investor* caught up recently with Orhan Sarayli, managing director and head of North America for Barings' Global Infrastructure Group, to explore the state of infra debt, one of the key take aways from the discussion is that the powerful tailwinds that are driving demand for infrastructure are stronger than any short-term events.

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Q What are the key benefits of infrastructure debt for investors?

Infrastructure debt has traditionally been the domain of banks and insurance companies. But investor appetite for the asset class has grown and we are now seeing interest from a broader spectrum of investors.

Exposure to infrastructure debt provides investors with diversification away from the broader macroeconomic factors that are prevalent throughout any asset allocation strategy. Historically, infrastructure has tended to be less correlated to economic cycles. That has now been proved through multiple scenarios, the two most recent being the pandemic and the global financial crisis, where infrastructure held up well from a ratings, default and loss rate perspective.

Meanwhile, infrastructure also provides the potential for excess value on a ratings equivalent basis. There is an incremental premium that investors can receive. In short, infrastructure debt offers benefits in terms of both risk and return.

What should investors be looking for in managers, particularly given current volatility?

Capturing the most compelling opportunities in infrastructure debt depends on the relationships with sponsors, banks and advisers. As a result, it is crucial for a manager to have strong origination capabilities. In addition, because private markets such as infrastructure debt are less liquid than public markets, the ability for investors to manage an investment's exit is also important. A manager needs to have the necessary relationships in place to exit an investment, as well as the ability and expertise to work itself out of a challenging position, if necessary.

Any portfolio, regardless of asset class, may encounter difficulties – and when that happens, managers need to have a specialist focus and a dedicated team that has a proven track record of dealing with a variety of challenges. We believe origination capabilities and portfolio management are the two areas that investors should really be digging into during their due diligence.

What sectors of infrastructure are currently favoured for investment?

The deal velocity we have seen, particularly in the US, in the first quarter of this year has been tremendous. While no single sector stands out, there has been a lot of publicity around digital infrastructure and data centres, in particular, with the acceleration of AI. There is also a lot of focus on power, including the power demand growth associated with digital infrastructure. But really, we are seeing strong growth across the board.

Even utilities have seen their capex profile change substantially over the past decade. Ten years ago, the top 10 US utilities were probably at breakeven in terms of their operating cashflow and capex needs.

Fast forward to today, and capex needs have massively increased, leading to an approximately $30 billion shortfall. What that means is that these utilities are having to access capital markets more often. This shortfall is also driving strategic decisions around partnerships and/or sales to free up capital to grow and meet the needs of their business models.

What's important to note is that the drivers of growth across all these forms of infrastructure are not closely correlated to economic cycles. Of course, volatility impacts capital deployment decisions, but these are long-term assets supported by fundamental tailwinds. As such, the capital requirement

What impact do you believe the Trump administration is likely to have on the infrastructure space?

We are closely monitoring all the policy decisions made by the Trump administration – especially the recent announcements around trade policy – that could impact the sectors in which we are active. These policies could have implications for transportation infrastructure, in particular. Although we believe that transportation assets will continue to be essential to a functioning economy, the question is how susceptible they are to these trade policies in the near term.

The energy sector is another one to watch. This administration has emphasised the importance of fossil fuels, suggesting fossil fuel-based infrastructure may be an interesting area. However, we believe renewable energy and renewable infrastructure remain attractive, and its penetration will continue to rise regardless of political leadership.

Historically, not only has infrastructure debt been largely immune to economic cycles, it has also been largely immune to administration cycles. While policy decisions are likely to have an impact on a case-by-case basis, overall, I believe the strong macro tailwinds supporting the entire infrastructure space make it unlikely that a single administration will substantially impact growth.

in this space continues to be substantial across all sectors.

When it comes to infrastructure debt sectors, I have no favourite child. In fact, what I enjoy most is being able to differentiate between the risk/reward offered by a transportation deal, a digital deal and a power deal.

Q Do you have a favourite when it comes to investment-grade or high-yield infrastructure debt?

We invest in both investment-grade and high-yield infrastructure debt, and we believe one feeds off the other. It is a highly symbiotic relationship and having the ability to play up and down the balance sheet is a critical advantage. Investment-grade portfolios offer investors a good entry point for the asset class – as they often come with ratings and the ability to play across multiple duration targets. They also offer an attractive return potential and provide a compelling opportunity with regards to diversification. In other words, they provide both alpha and beta.

Meanwhile, the high-yield space tends to be less trafficked than the investment-grade space. This provides investors the opportunity to find relatively untapped markets and therefore to generate a better relative risk-adjusted return, which is something we find to be particularly compelling.

Q Infra may be relatively uncorrelated to economic cycles, but could interest rate declines impact the performance of the asset class?

There is no doubt that interest rate movements will impact capital-intensive infrastructure businesses in every sector. However, what is particularly appealing about this asset class is that the need for infrastructure debt, whether for greenfield, M&A or refinancings, never stops.

Over the past couple of years, when interest rates have been rising, there has been a significant downturn in M&A. But, on the flipside, the yields we've been returning to investors during this period have been substantially improved, driven by an uplift in both base rates and spreads. Historically, investors have been able to generate returns closer to core or core-plus equity strategies, but through a senior secured or junior double B debt instrument. That seems to have been compelling from a relative value perspective.

"The need for infrastructure debt, whether for greenfield, M&A or refinancings, never stops"

If interest rates do continue their downward trajectory, we can expect to see an uptick in greenfield and M&A activity – with a caveat, of course, around current geopolitical events. This could provide a deeper and broader opportunity set to select deals from. None of this is to take away from the fact that interest rate movements do have an impact, but as infrastructure debt lenders, opportunities can emerge whether those rate movements are upward or downward.

Q What trends and developments do you anticipate in the infrastructure debt asset class over the next few years?

If the infrastructure space is going to continue to grow at the meteoric pace that we have seen over recent years, the capital source universe will likely need to broaden away from its disproportionate reliance on banks, insurance companies and private markets funds. The challenge, however, is that while it is relatively easy for a private individual or smaller institutions to access certain markets like real estate, for example, the same isn't currently true for infrastructure. At some point this accessibility will have to change.

It is incumbent on capital markets – the borrowers, the banks and players like us – to figure out how to diversify the capital-sourcing universe for this asset class. How and when that happens remains to be seen, but it must happen if infrastructure is going to continue to grow in the way that each of these subsectors requires. ■